Supreme Court, U.S.
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No. 04-

IN THE

Supreme Court of the United States

SL SERVICE, INC.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the 50% duty on "expenses of repairs" performed in foreign shipyards that is imposed by the federal vessel repair statute applies to expenses (such as dry-docking) that are not actual repair expenses, and would have been incurred even if no repairs were performed.

STATEMENT REQUIRED BY RULE 29.6

Pursuant to Rule 29.6 of the Rules of this Court, petitioner states that its parent corporation is CSX Corporation and that no other publicly held corporation owns 10 percent or more of petitioner's stock.

All parties to the proceeding are listed in the caption of the case.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner SL Service, Inc. ("SL Service") respectfully requests that this Court grant its petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit.

OPINIONS BELOW

The opinion of the Federal Circuit is published at 357 F.3d 1358 (2004) and appears in the Appendix of this Petition ("App.") at 1a-12a. The Federal Circuit's unpublished order denying the petition for rehearing and rehearing *en banc* appears at App. 22a-23a. The opinion of the Court of International Trade granting summary judgment on behalf of SL Service is published at 244 F. Supp. 2d 1359 (2002) and appears at App. 13a-21a.

JURISDICTION

The court of appeals entered judgment on February 4, 2004, and denied a timely petition for rehearing on April 12, 2004. This Court extended the time for filing a petition for certiorari to and including August 10, 2004. This Court has jurisdiction under 28 U.S.C. § 1254(1).

RELEVANT PROVISIONS OF LAW

The federal vessel repair statute is codified at 19 U.S.C. § 1466 and is reproduced at App. 24a-28a.

The Customs Service regulations implementing the vessel repair statute appear at 19 C.F.R. § 4.14 and are reproduced at App. 29a-39a.

STATEMENT OF THE CASE

This case presents an important question of federal law with serious implications for the U.S.-flag shipping industry. A divided United States Court of Appeals for the Federal Circuit has impermissibly broadened a 19th-century tariff statute in a way that flouts the letter and the spirit of the statute and departs from a century of Customs Service practice. Moreover, the Federal Circuit's new interpretation of the statute is arbitrary and directly contravenes that court's own prior interpretation announced just a decade ago. The substantial additional, unwarranted duties that U.S.-flag ships will have to pay as a result of the decision below will further weaken an American merchant marine industry already laboring under severe competitive disadvantages. The decision of the Federal Circuit thus warrants this Court's review.

Industry Background

The U.S.-Flag Fleet. The U.S.-flag commercial fleet is vital to the strength and security of the nation. In addition to the economic importance of the merchant shipping industry, the U.S.-flag fleet fills the strategic need for an American-owned marine transportation system (without which U.S. importers and exporters would be wholly dependent on foreign interests) and serves as a naval and military auxiliary in times of war and emergency.[1] These important national interests

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[1] U.S.-flag ships, manned by American civilian mariners, play a central role in staging and supporting military operations, providing the sealift capacity needed to undertake and sustain an overseas engagement. See U.S. Mar. Admin., *Maritime Security Program*, *available at* http://www.marad.dot.gov/programs/msp/msp.html (last visited Aug. 10, 2004). The Defense Department simply is not capable of effecting the necessary cargo movements at a bearable cost. For instance, nearly half of the cargo for the 1991 Persian Gulf War was carried on U.S.-flag ships crewed by civilian mariners. See H.R. Rep. No. 104-229, at 10 (1995), *reprinted in* 1996 U.S.C.C.A.N. 3521, 3522. Relying on foreign-flag vessels to meet the sealift needs of the military during wartime would place vital supply lines in the hands of foreign interests, presenting obvious and

depend on the regular operation of commercial vessels flying the American flag, a reliable pool of trained civilian mariners to man them, and the ability and willingness of the private maritime industry to make the necessary capital investments.

For these reasons, it has long been a staple of federal policy "to develop and encourage the maintenance of a merchant marine." Act of June 5, 1920, § 1, ch. 250, 41 Stat. 988, 988. As Congress declared in the landmark Merchant Marine Act of 1936,

> [i]t is necessary for the national defense and development of its foreign and domestic commerce that the United States shall have a merchant marine (a) sufficient to carry its domestic water-borne commerce and a substantial portion of the water-borne export and import foreign commerce at all times, (b) capable of serving as a naval and military auxiliary in time of war or national emergency, (c) owned and operated under the United States flag by citizens of the United States, insofar as may be practicable, (d) composed of the best-equipped, safest, and most suitable types of vessels, constructed in the United States and manned with a trained and efficient citizen personnel.

46 U.S.C. app. § 1101. The policy remains unchanged today, as evidenced by the Maritime Security Act of 1996, Pub. L. No. 104-239, 110 Stat. 3118, enacted to "assure the retention by the United States of an active, privately owned, U.S.-flag and U.S.-crewed merchant shipping fleet to meet national and foreign commerce needs and to provide sustainment sealift capability in time of war or national emergency." H.R. Rep.

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unacceptable risks. See Raymond J. Decker, U.S. GAO, Rep. No. GAO-03-15, *Actions Needed to Improve Force Protection for DOD Deployments Through Domestic Seaports* 8 (Oct. 22, 2002). The merchant marine also has important frontline roles in detecting and preventing threats to port security. See, *e.g.*, Maritime Transportation Security Act of 2002, Pub. L. No. 107-295, § 101(13), 2002 U.S.C.C.A.N. (116 Stat. 2064) 2067 (codified at 46 U.S.C. § 70101 note).

No. 104-229, at 9 (1995), *reprinted in* 1996 U.S.C.C.A.N. 3521, 3521.

But the fleet is waning. From its heyday after World War II when the U.S.-flag merchant fleet carried nearly half the world's seaborne cargo, the fleet has steadily shrunk as cargo increasingly is shipped under flags of foreign countries offering tax incentives and lax regulations. From a post-war high of 1268 ships of at least 1000 gross tons in 1951, the private U.S.-flag fleet had declined to 237 vessels in 2003. U.S. Mar. Admin., *U.S.-Flag Merchant Fleet* (2003), *available at* http://www.marad.dot.gov/marad_statistics/US-Flag-History.pdf. In this environment, American shipping companies operate on razor-thin margins, which are squeezed by stark differentials in operating costs and regulatory burdens and by subsidies to foreign merchant fleets.[2] Increases in the cost of doing business can be devastating, driving some vessel owners out of the trade and slashing the already lean profits of those that remain. Investment capital has dwindled, with the predictable impact on operations and recruiting.

Among other disquieting concomitants of this trend, the civilian manpower and sealift capability for overseas military engagements have fallen to dangerously low levels. See *id.* Yet the strategic need for a viable U.S.-flag fleet is perhaps greater than in living memory. Given the extent of America's military commitment around the world, its unprecedented dependence on foreign trade for vital commodities, and the vulnerability of the nation's ports and related infrastructure, a vital U.S.-flag merchant fleet is not a luxury. In the words of the agency charged with overseeing the merchant marine:

> Ninety-five percent of the Nation's overseas trade moves by water, but only about three percent is carried by the

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[2] A U.S.-flag ship typically costs as much as $4 million more in annual operating costs than an identical ship flying a foreign flag. Robert Little, *Ships Without Sailors (pt. 2 of 2): U.S. Merchant Fleet Sails Toward Oblivion*, Balt. Sun, Aug. 6, 2001, at A1.

> U.S.-flag fleet. This has disturbing implications for America's national security and economic vigor. Without a U.S.-flag fleet, the Nation's foreign commerce and auxiliary sealift capability would depend entirely on foreign-flag ships.

U.S. Mar. Admin., *2002 Annual Report* 5 (2003).

In recognition of the continuing importance and the shaky condition of the flag fleet, Congress has acted several times in recent decades to enhance the fleet's competitiveness. In 1981, Congress granted shipowners temporary but vital relief from the requirement that government-preference cargo be shipped on U.S.-built vessels. See Omnibus Budget Reconciliation Act of 1981, Pub. L. No. 97-35, tit. XVI, 95 Stat. 357, 751.[3] The Shipping Act of 1984, Pub. L. No. 98-237, 98 Stat. 67, created an enhanced antitrust exemption for conference rate-setting by U.S.-flag ship owners and sanctioned their participation in foreign consortia—protections augmented by the Ocean Shipping Reform Act of 1998, Pub. L. No. 105-258, 112 Stat. 1902. Also in 1984, Congress established a commission to "study problems relating to [the] . . . merchant marine" and to recommend remedial action. Department of Defense Authorization Act of 1985, Pub. L. No. 98-525, § 1536(b), 98 Stat. 2492, 2633. When these piecemeal remedies proved unequal to the pressures on the merchant fleet, Congress in the Maritime Security Act of

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[3] Under the Cargo Preference Acts of 1904 and 1954, 100 percent of U.S. military cargoes, 50 percent of U.S. government non-military cargoes, and 75 percent of agricultural assistance exports must be carried on U.S.-built ships. *See* Military Cargo Preference Act of 1904, ch. 1766, 33 Stat. 518; Military Cargo Preference Act of 1954, Pub. L. No. 664, ch. 936, 68 Stat. 832; Food Security Act of 1985, Pub. L. No. 99-198, § 1142, 99 Stat. 1354, 1491-92. American shipowners took advantage of the 1981 dispensation to acquire more than 30 ships from foreign yards, a substantial and much-needed boost to the aging flag fleet. *See* Andrew Gibson & Arthur Donovan, *The Abandoned Ocean: A History of United States Maritime Policy* 257-58 (2000).

1996, Pub. L. No. 104-239, 110 Stat. 3118, created a regime of substantial operating subsidies.

Coast Guard Inspections. All vessels flying the U.S. flag are required to undergo regular examinations or inspections by the United States Coast Guard and the American Bureau of Shipping ("ABS").[4] See 46 C.F.R. §§ 2.01-10(b), 90.05-1(a), 91.01-1. Under Coast Guard rules, these examinations must occur at least two times in a five-year period, with no more than three years elapsing between any two examinations. See *Id.* § 91.40-3. These examinations require the vessels to be taken out of service for a period of time to be dry-docked, typically two weeks or more. *Id.*

Because of the high cost of dry-docking a large cargo ship and the substantial opportunity cost of having the ship out of commission, owners and operators of American-flag vessels commonly arrange for nonemergency repairs and modifications to be performed while a ship is in dry dock for Coast Guard and ABS inspections.

Over the years, it has become increasingly difficult and costly for American-flag vessels to schedule inspections at United States shipyards. Many domestic shipyards have shifted their work primarily or even exclusively to construction and repair of Navy and Coast Guard ships, with much of the remaining availability reserved for passenger cruise lines able and willing to pay top dollar. Consequently, fewer and fewer domestic shipyards have the docking capacity and scheduling to meet the requirements of large commercial ship

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[4] ABS is a private organization that certifies ships as seaworthy. Because it is required for insurance purposes, certification by a recognized entity (ABS is the second-largest, after Lloyd's Register in Britain) is effectively a prerequisite of modern commercial shipping. Under the Coast Guard's Alternate Compliance Program (*see* 46 C.F.R. pt. 8), ABS and certain others are delegated authority to inspect and certify U.S.-flag ships. Therefore, ABS inspections and Coast Guard inspections are usually one and the same.

owners. Sometimes no domestic shipyard is available or will even bid on a project; at other times, the only domestic yard that is available is markedly less efficient and more expensive than equivalent yards in most foreign ports—typically requiring at least 50 percent more time for a given job, at about triple the cost. In many cases, therefore, owners of U.S.-flag vessels have little or no choice but to contract with foreign shipyards to comply with Coast Guard and ABS inspection mandates.

The Vessel Repair Statute

The federal vessel repair statute imposes a 50 percent duty on the cost of repairs made in foreign countries on U.S.-flag vessels. The statute provides in relevant part that

> the expenses of repairs made in a foreign country upon a vessel documented under the laws of the United States to engage in the foreign or coasting trade . . . shall, on the first arrival of such vessel in any port of the United States, be liable to entry and the payment of an ad valorem duty of 50 per centum on the cost thereof in such foreign country.

19 U.S.C. § 1466(a). The statute was enacted in 1866 to aid a domestic shipbuilding industry that had been decimated by a perfect storm of Civil War casualties, war-panic divestments of merchant ships, and the rise of iron ships coincident with a steep tariff on iron and steel. See H. David Bess & Martin T. Farris, *U.S. Maritime Policy: History and Prospects* 23-24 (1981). Since then, the statute has been reenacted from time to time with modifications (primarily to ameliorate its impact on ship owners), but the language quoted above remains largely unchanged since the original enactment.

Self-evidently, one purpose of the statute is to protect the American shipbuilding and ship-repairing industry by encouraging the use of American shipyards for repairs to U.S.-flag vessels. See *South Corp.* v. *United States*, 690 F.2d 1368, 1372 (Fed. Cir. 1982) (en banc) ("In enacting § 1466(a) Con-

gress sought to protect and encourage American ship repair facilities."); *Erie Navigation Co.* v. *United States*, 475 F. Supp. 160, 163 (Cust. Ct. 1979) ("the purpose of section 1466(a) was to protect the American shipbuilding and repairing industry"); Duty on Repairs for American Vessels, 33 Op. Att'y Gen. 432, 434 (1923) (statute's goal is "to protect the American manufacturer of ship parts").

The statute's concern for shipbuilders and dockworkers, however, is balanced by a concern for the interests of ship owners and operators, and Congress has always taken care not to upset that balance. For example, the duty is not meant to apply where a vessel's return to the U.S. for repairs is impossible or impracticable. As originally enacted, the statute applied only to vessels "engage[d] in the foreign and coasting trade on the northern, northeastern and northwestern frontiers of the United States," thus excluding ships too far away practicably to return to the U.S. for repairs.[5] The modern equivalent of that limitation is an exemption for vessels that are at sea for two years or more. 19 U.S.C. § 1466(e). Also, the statute authorizes the remission of duties on the cost of foreign repairs occasioned by stress of weather or other casualties. *Id.* § 1466(d); see 19 C.F.R. § 4.14(h)(2).

And where the statute does apply, it does not reach all work performed in foreign shipyards. Costs associated with Coast Guard and ABS inspections, including work incidental to inspections, are not subject to duty. *Vessel Repairs*, 14 Cust. B. & Dec. 1061 (Cust. Serv. 1980); *Vessel Repair*, 13 Cust. B. & Dec. 1395 (Cust. Serv. 1979). Modifications, alterations, and additions to the hull and fittings of a vessel are not subject to duty. *Carriers*, 23 Cust. B. & Dec. 777 (Cust. Serv. 1989);

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[5] Act of July 18, 1866, ch. 201, § 23, 14 Stat. 178, 183-84. With this geographic limitation, Congress aimed to confine the burden to those vessels "that could most easily purchase and conduct repairs in the United States." Lawrence M. Hadley, Note, *The Fifty Percent Ad Valorem Duty on Foreign Ship Repairs: Scope of Application and Proposals for Elimination*, 24 Geo. Wash. J. Int'l L. & Econ. 415, 420-21 (1990).

see *United States* v. *Admiral Oriental Line*, 18 C.C.P.A. 137 (1930).[6] The statute expressly exempts from duty the cost of equipment, repair parts or materials for LASH barges, as well as the costs of spare parts and materials for which duties have been paid. 19 U.S.C. § 1466(h); see 19 C.F.R. § 4.14(h)(4); Customs Headquarters Memorandum No. 113291 from Stuart P. Seidel, Assistant Commissioner, Office of Regulations & Rulings, to All Vessel Repair Liquidation Units (May 31, 1995). Compensation paid to regular crew members in connection with dutiable repairs is also exempt. 19 U.S.C. § 1466(a).

At least once in recent years, a proposal to expand the reach of the vessel repair statute beyond repair costs was brought to Congress. In 1990, the Customs Service lobbied for an amendment to the statute that would have allowed Customs to collect duty on "all costs and expenses associated with" overseas repairs. The proposed amendment died in committee.[7]

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[6] Customs has long distinguished nondutiable modifications from dutiable repairs by considering the following factors: (1) whether there is a permanent incorporation into the hull or superstructure of a vessel, either in a structural sense or as demonstrated by means of attachment so as to be permanently incorporated; (2) whether in all likelihood an item under consideration would remain aboard a vessel during an extended layup; (3) whether, if not a first time installation, an item under consideration replaces a current part, fitting, or structure that is not in good working order; and (4) whether an item under consideration provides an improvement or enhancement in operation or efficiency of the vessel. See, *e.g.*, Customs Headquarters Memorandum No. 113474 from William G. Rosoff, Chief, Entry & Carrier Ruling Branch, to Chief, Liquidation Section, U.S. Customs Service (Oct. 24, 1995), *available at* http://rulings.customs.gov.

[7] This was one of a series of proposed amendments to the Customs Modernization Act of 1990. The original proposal sent by the Customs Service to the House Ways and Means Committee does not appear in the public record. The transmittal letter is cited at 136 Cong. Rec. H7211, H7214 (Exec. Comm. No. 3797) (daily ed. Sep. 5, 1990).

Background of the Case

From November 22 through December 1, 1995, the Sea-Land *PACIFIC*, a U.S.-flag cargo vessel owned by Sea-Land Service, Inc. (now known as SL Service), was dry-docked in Hong Kong to undergo mandatory Coast Guard and ABS inspections, as well as nondutiable modifications. App. 15a. It was agreed by the parties that the vessel was not in dry dock for any time longer than necessary for the inspections and modifications. *Id.* at 15a & 16a n.2. While in dry dock, the *PACIFIC* underwent dutiable repair and overhaul work costing $565,357. On the ship's re-entry, Customs assessed a 50 percent duty on the cost of that work, as required by the vessel repair statute. However, Customs also assessed duty on approximately half of the dry-docking general service expenses, based on the share of the total expenditures occupied by dutiable repair costs. App. 19a ("the dutiable and non-dutiable dry-docking expenses were apportioned by Customs according to the percentage corresponding to the value of dutiable repairs and non-dutiable expenses incurred" during the period the ship was in dry dock). Based on the ratio of total dutiable to nondutiable expenditures, $25,084 of the $49,896 in dry-docking general service expenses incurred by the *PACIFIC* was subject to the 50 percent repair duty. The duties attributable to the dry-docking expenses totaled $12,542.

SL Service timely filed an administrative protest challenging the assessment of duty on the dry-docking expenses.[8] Upon denial of its protest, SL Service paid the contested duties and filed an action in the U.S. Court of International Trade ("CIT") challenging the protest denial. The CIT held that Customs had misapplied the repair statute and entered summary judgment for SL Service. The court applied the test

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[8] The total impact on SL Service extends well beyond the duties at issue in this test case. In addition to the vessel repair duties on the *PACIFIC*, challenged duties on 14 other entries of SL Service ships await the resolution of this case.

established by the Federal Circuit in *Texaco Marine Services, Inc.* v. *United States*, 44 F.3d 1539 (Fed. Cir. 1994), which interpreted the statutory phrase "'expenses of repairs'" as covering "all expenses (not specifically excepted in the statute) which, but for dutiable repair work, would not have been incurred." *Id.* at 1544. The CIT held that under *Texaco* dry-docking expenses would be dutiable only if Customs could clearly identify dry-docking expenses that were "undertaken solely for the purpose of repair." App. 18a. "Therefore, only the maintenance expense of dry-docking for the period of time in excess of that necessary for a mandatory inspection and/or modifications are dutiable under the *Texaco* test." *Id.* at 19a-20a. The court reasoned that, because the cost of dry-docking was "an inevitable expense of a mandatory inspection," and because Customs had admitted (and the record clearly showed) that the *PACIFIC* was not dry-docked for any period in excess of the time necessary for the mandatory inspections and modifications, none of the dry-docking expenses was properly subject to the vessel repair duty. *Id.* at 19a-21a.

A divided panel of the Federal Circuit reversed. App. 1a-12a. The majority held that dry-docking expenses may be considered "expenses of repairs" under the vessel repair statute if repairs are made while the ship is in dry dock—even if, as here, the reason it was docked in a foreign port was to undergo nondutiable inspections. *Id.* at 7a. And, the majority endorsed Customs' proposed apportionment method, creating a new "dual purpose" test under which duty would be charged on a portion of dry-docking expenses corresponding to the proportion of dutiable expenses incurred while the ship was in dry dock. *Id.* at 7a-8a.[9]

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[9] For example, if a ship were in dry dock for modifications that cost $2,000, and also undertook a repair costing $8,000, 80 percent of the dry-docking costs would be subject to the vessel repair duty.

Judge Bryson dissented. He argued that "the dry-docking expenses in this case should not be dutiable because those expenses would have been incurred irrespective of whether or not dutiable repairs had been performed." App. 11a. He observed that the majority's method of parsing and apportioning dry-docking costs "finds no support in the vessel repair statute. . . . [I]n fact, the statute contains no reference to apportionment at all, which suggests that Congress did not have in mind that Customs would subdivide 'multiple cause' expenses into dutiable and nondutiable portions." *Id.* at 12a.

REASONS FOR GRANTING THE PETITION

The decision below is arbitrary and threatens further to weaken the U.S.-flag merchant fleet, and therefore demands this Court's review. The Federal Circuit's new "interpretation" of the vessel repair statute not only departs from the plain language of the statute, a century of Customs practice, and common sense, but also is inconsistent with the Federal Circuit's own interpretation of the statute just a decade ago. The decision below portends considerable harm to a merchant marine that is already struggling, undercutting a long line of federal remedial legislation designed to afford U.S.-flag vessel owners relief from the duty. At the same time, the Federal Circuit's new rule does not further the purpose of the repair statute, or effect any cognizable benefit that remotely compensates for the injury to a vital national industry.

Moreover, because the Federal Circuit has exclusive appellate jurisdiction of cases involving disputes over customs duties, see 28 U.S.C. §§ 1295(a)(5), 1581(a) & (b), the issues raised by this case will not be further vetted in the lower courts. In light of the importance of the issues for the maritime industry and the nation as a whole, the Court should review the Federal Circuit's decision.

I. THE ARBITRARY DECISION OF THE FEDERAL CIRCUIT EXTENDS AND DEEPENS CONFUSION IN THE CASE LAW THAT REQUIRES THIS COURT'S RESOLUTION.

For more than a century, the vessel repair statute was understood, in keeping with its plain language, to impose a duty only on the cost of foreign repairs themselves—on "expenditures made for foreign materials or for foreign labor employed in making repairs." T.D. 39443, 43 Treas. Dec. 99, 100 (1923). Expenses incidental to repair work were not subject to duty under the statute. See, *e.g.*, *Mount Washington Tanker Co.* v. *United States*, 505 F. Supp. 209 (Ct. Int'l Trade 1980) (reversing assessment of duty on the cost of transporting workers to perform repairs), *aff'd*, 665 F.2d 340 (C.C.P.A. 1981); *International Navigation Co.* v. *United States*, 148 F. Supp. 448, 455 (Cust. Ct. 1957) (reversing assessment of duty on the cost of transporting men and materials for repair work); *American Viking Corp.* v. *United States*, 150 F. Supp. 746, 752 (Cust. Ct. 1956) (reversing assessment of duty on the cost of lighting necessary to perform repairs).

Significantly, the cost of dry-docking a ship that undergoes repairs in a foreign shipyard was held almost a century ago to be nondutiable under the vessel repair statute. *United States* v. *George Hall Coal Co.*, 134 F. 1003, 1003 (S.D.N.Y. 1905) ("the expenses of docking a vessel while undergoing repairs in a foreign port is not subject to the payment of a duty"), *aff'd*, 142 F. 1039 (2d Cir. 1906) (per curiam). In the *George Hall* decision, the Board of General Appraisers (a predecessor of the Court of International Trade) reasoned that such foreign dry-docking expenses were not dutiable because "'[t]he mere drawing up of a vessel on a dry dock is not a part of her repairs, but is rather a method of making an inspection of her to determine whether any repairs are necessary.'" *Texaco*, 44 F.3d at 1546 (quoting the Board's ruling).

A. "Expenses of Repairs" Was Reinterpreted In *Texaco*.

In *Texaco*, the Federal Circuit expanded the reach of the repair statute by interpreting "expenses of repairs" to embrace certain expenses incidental to dutiable repairs. In that case, Customs had assessed duty on the costs of protective covering equipment in preparation for ship repairs and of cleaning up after the repairs; the ship owner objected on the ground that the taxed items were not repair expenses. 44 F.3d at 1541-42. The CIT entered summary judgment in favor of Customs, *id.* at 1542. The Federal Circuit affirmed, holding that (notwithstanding prior precedent) as a matter of plain language "expenses of repairs" should be construed "as covering all expenses . . . which, but for dutiable repair work, would not have been incurred." *Id.* at 1544. The Federal Circuit overruled the *Mount Washington*, *International Navigation*, and *American Viking* cases discussed above, see *id.* at 1546-47, but insisted that its "but for" test was consistent with the century-old *George Hall Coal* decision, which it interpreted as "stand[ing] for the proposition that expenses that would have been incurred irrespective of whether or not dutiable repairs are performed are not dutiable as an expense of repairs." *Id.* at 1546.

Under *Texaco*'s newly minted "but for" construction of the repair statute, a wide range of theretofore nondutiable expenses ancillary to repair work (such as the cleaning expenses at issue in *Texaco*) were brought within the statute's ambit. The Customs Service pointedly noted the sweeping change effected by *Texaco* in a letter ruling issued shortly after the Federal Circuit's decision:

> It is readily apparent that this case has wide-ranging ramifications with respect to Customs liquidation of vessel repair entries. For example, as you well know we currently do not consider the following foreign costs dutiable under the vessel repair statute: air, crane, drydocking charges, electricity, travel/transportation, launch

> use, lodging, security and staging. Absent these costs being incurred pursuant to [non-dutiable work], they would undoubtedly constitute [dutiable] "expenses of repairs" under the "but for" test . . . .

Memorandum from Stuart P. Seidel, Assistant Commissioner, U.S. Customs Office of Regulations & Rulings, to New Orleans Regional Director, Commercial Operations Division (Jan. 18, 1995), *available at* 1995 WL 64779.

B. The Federal Circuit Has Now Abandoned *Texaco*.

A decade later, in the decision below, a divided Federal Circuit abandoned the *Texaco* "but for" test as the generally applicable plain-language interpretation of the statutory phrase "expenses of repairs," and upheld for the first time the imposition (contrary to 100 years of prior Customs practice) of duties on dry-docking costs. The majority below did not expressly overrule *Texaco* or a later case applying *Texaco*, *Sea-Land Service, Inc.* v. *United States*, 239 F.3d 1366 (Fed. Cir. 2001), but held that "[t]he precedential force of *Texaco* applies only to single-purpose expenses." App. 5a. If dry-docking has "dual" purposes, by contrast, then Customs is entitled to apportion expenses between nondutiable work and dutiable repairs. *Id.*

The panel majority thus turned away from both the language of the statute (which limits the vessel repair duty to vessel repair expenses) and the "but for" gloss of *Texaco*, and created a new rule whereby undertaking repairs has a ripple effect, exposing vessel owners to potentially enormous liability for expenses that have nothing to do with repairs.[10]

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[10] The ruling affects a wide range of expenses in addition to the cost of dry-docking itself. As Customs has noted, in a rulemaking dealing with the vessel repair statute:

> Drydocking is a major, but not isolated, expense in general ship repair operations. Many other associated expenses and services are necessary adjuncts to drydocking and are logically inseparable from the

Not only did the majority's holding depart from the repair statute and from its recent *Texaco* decision (as well as decades of pre-*Texaco* administrative and judicial precedent), but it is wholly unjustifiable even on its own terms. To support its new rule, the majority pointed to exceptions to the but-for test of causation in tort law. The majority noted that in tort law cause-in-fact may be established even if the injury would have occurred because of a concurrent cause, citing the case in which two negligently caused fires together destroyed property. App. 6a-7a (citing *McClellan* v. *St. Paul, M. & M. Ry.*, 59 N.W. 978 (Minn. 1894)). As an initial matter, it is highly irregular to seek guidance from common law tort doctrine in construing a customs statute. As Judge Bryson pointed out in dissent, under the vessel repair statute, "the question is not whether and how to compensate the victim of a wrong." *Id.* at 11a. Equally fundamentally, the cited tort law doctrine does not support the result reached by the Federal Circuit. The evidence in the record does not establish that the *PACIFIC* had to be dry-docked in Hong Kong for these repairs; rather, it was undisputed that the reason the ship was dry-docked abroad was to comply with federal inspection mandates. In other words, the repairs did not "cause" the foreign dry-docking, or any part of it.

Its citation of tort law causation doctrine notwithstanding, the Federal Circuit did not simply modify the *Texaco* "but for" test and adopt a "cause-in-fact" test in determining ex-

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drydocking rule. These include such items as drydock block arrangement, sea water supply (for firefighting equipment), hose hookup and disconnection charges, fire watch services, the services of a crane for drydocking-related operations, the provision of compressed air, cleaning of the drydock following repairs, among numerous others. These necessary services are costly, are supplied at nearly each drydocking, and had until recently been considered to be classifiable as duty-free.

Foreign Repairs to American Vessels, 66 Fed. Reg. 16,392, 16,393 (Mar. 26, 2001). Now all such expenses are subject to the vessel repair duty, even if the ship was in dry dock by reason of nondutiable work.

penses of repair. Instead, the Federal Circuit adopted a very different "necessary condition" test for so-called dual-purpose expenses. Under this test, there does not have to be evidence that the need for repairs was a cause in fact of the dry-docking in a foreign port—for indeed there was no evidence that the *PACIFIC* would have dry-docked in Hong Kong to perform the repairs. The *PACIFIC* dry-docked in Hong Kong simply because that was the best available port that would enable the *PACIFIC* to meet its inspection obligations. Because the ship would already be in dry dock, petitioner arranged for certain repairs that eventually needed to be done (as well as any new repairs that might be discovered while the ship was docked); such repairs had no causal relationship to the Hong Kong dry-docking. Petitioner thus would have prevailed below under a cause-in-fact test (as well as under the *Texaco* but-for test). Instead of looking to whether the need for repairs was an actual cause in fact of the foreign dry-docking, the majority below looked instead to the nature of the repairs, and whether as a general matter they could have been performed without dry-docking *at some point*. The Federal Circuit thus in effect held that dry-docking expenses are dutiable if dry-docking is a necessary condition for implementing the repairs: *i.e.*, in the Federal Circuit's words, if dry-docking was "required by dutiable repairs." App. 7a.

C. The Federal Circuit's Ruling Is Arbitrary.

The Federal Circuit's construction of the vessel repair statute is arbitrary in five separate respects. First, it is arbitrary as a matter of statutory construction. The general rule is that customs statutes are interpreted according to the ordinary sense of the language used by Congress, see *Texaco*, 44 F.3d at 1543, with courts entitled to give appropriate weight in resolving ambiguity to the persuasive interpretations of the Customs Service under *Skidmore* v. *Swift & Co.*, 323 U.S. 134 (1944). See *United States* v. *Mead Corp.*, 533 U.S. 218, 234-35 (2001). In *Texaco*, as noted above, the Federal Circuit rejected the longstanding agency and judicial construction of

the statute limiting duties to the actual expenses of repairs, ruling as a matter of putative plain language that the term "expenses of repairs" broadly covered other kinds of expenses that would not have been incurred but for the repair (regardless of whether they were required by that repair). 44 F.3d at 1546. But now that putative plain meaning does not hold if dry-docking serves so called "dual purposes" of inspection and repair. In the latter circumstance, the simple term "expenses of repairs" has the opposite meaning: dual-purpose expenses like dry-docking are dutiable if they are required to perform the repair (regardless of whether they would have been incurred but for the repair). App. 7a. Neither part of this contradictory, hybrid test has anything to do with the plain meaning of the simple term "expenses of repairs" in the statute. The statute contemplates that an expense either is or is not a dutiable expense of repair. Congress did not create such a hybrid expense, as the Federal Circuit has done.

Second, the Federal Circuit's new test is arbitrary as a matter of administrative law. In *Sea-Land*, the Federal Circuit confirmed that its *Texaco* but-for test was a judicial construction of the statute's plain meaning from which the Customs Service was not free to depart. See *Sea-Land*, 239 F.3d at 1372-73. Perhaps (if this case had gone *en banc*) the Federal Circuit could have decided to overrule *Texaco* and *Sea-Land* and adopt a new, generally applicable interpretation of the statutory term "expenses of repairs," relying on the positions espoused by Customs to the extent of their persuasiveness as to statutory meaning. *Mead*, 533 U.S. at 234. Instead, the majority left *Texaco* and *Sea Land* intact as precedent, App. 5a, with the perverse result that the single term "expenses of repairs" has a plain meaning from which Customs cannot depart in some circumstances, and a different and mutually exclusive meaning in other circumstances whereby Customs's newfangled apportionment test is upheld simply because it is (in the panel majority's view) "rational." *Id.* at 7a.

Third, not only did the majority below give the vessel repair statute a new and unreasonable interpretation, but also it rubber-stamped the Customs Service's capricious apportionment methodology that, as Judge Bryson pointed out, "finds no support in the vessel repair statute." App. 12a (Bryson, J., dissenting).

> The government's method requires Customs to apportion the costs in question between dutiable costs of repair and other, nondutiable costs. The statute, however, offers no guidance as to how such an apportionment should be conducted; in fact, the statute contains no reference to apportionment at all, which suggests that Congress did not have in mind that Customs would subdivide "multiple causes" into dutiable and nondutiable repairs.

Id. The majority's claim that it accepted Customs's apportionment test out of deference to "Customs' long-standing practice," *Id.* at 8a, is disingenuous. The majority relied on three letter rulings where Customs apportioned for one special and minor kind of expense (the cost of obtaining a gas free certificate). See *id.* For every other kind of ancillary expense (including dry-docking), the longstanding practice of Customs was not to apportion, but simply to treat those nonrepair expenses as nondutiable. If the majority had given longstanding administrative practice its due (or abided by its own interpretation in *Texaco*), it would not have embraced the Customs Service's contrived apportionment method.

Fourth, the Federal Circuit arbitrarily blessed an apportionment method that is antithetical to its own construction of the statute. If indeed the majority's construction of the statute were correct, the logical basis for apportionment should only be those repairs that require dry-docking, see App. 7a. Instead, the Customs Service apportions on the basis of *total* repair expenses. The numerator in the dutiable/nondutiable ratio is not repairs requiring dry-docking, but simply "dutiable repairs," undifferentiated. *Id.* at 2a; accord Customs

Headquarters Memorandum No. 115194 from Larry L. Burton, Chief, Entry Procedures & Carriers Branch, to Chief, Residual Liquidation & Protest Branch, U.S. Customs Service (Dec. 19, 2000), *available at* http://rulings.customs.gov. Thus, if a ship while in dry dock had inspection and modification costs of $5,000, repairs of $5,000 that required dry-docking, and repairs of $40,000 that did not require dry-docking, then 90% of the dry docking expenses would be dutiable even though only 10% of the inspection, modification, and repair expenses would fall within the Federal Circuit's "required by dutiable repairs" standard. The majority's approach defies common sense and does violence to both the text and the policy of the statute.[11]

Finally, the Federal Circuit's new method yields the incongruous result that actual repair expenses become in many cases a small part of the base on which "repair" duties are assessed. By way of illustration, take two ships, each dry-docked at a cost of $60,000. Each ship while in dry dock undergoes ABS inspections costing $10,000 and dutiable repairs costing $50,000 (the repairs do not require dry-docking for any period exceeding that necessary for the mandatory inspections). Ship 1 undergoes no modifications, but Ship 2 spends $1 million on nondutiable modifications. On re-entry to the U.S., Ship 1 will be assessed a 50% duty on $50,000 in dry-docking expenses (because dutiable repairs accounted for 5/6 of total expenditures while in dry dock); Ship 2 will be assessed a 50% duty on approximately $2,500 in dry-docking expenses (because dutiable repairs accounted for just under five percent of its expenditures).

This wide disparity cannot be justified on any reasonable reading of the repair statute, because the disparity derives principally from the happenstance of greater or lesser expen-

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[11] There is evidence in the record that not all the Hong Kong repairs required dry-docking. *See* J.A. 838, *SL Serv.* v. *United States*, 357 F.3d 1358 (Fed. Cir. filed July 21, 2003).

ditures that are *not* independently subject to duty under the statute. In the hypothetical above, Ship 1 pays $50,000 in total duties (on the repair and the allocable dry-docking expenses); Ship 2 pays $21,250. Thus, Ship 1 pays almost $30,000 more in duties, even though the two ships spent the same amounts for dry-docking and repairs. And, considering that dry-docking expenses often occupy a large share of the costs incurred by a vessel in dry dock, the disparity hits hard at the bottom line. Nor would the duty assessed on Ship 1 in this hypothetical further the statute's purpose, which is to capture a share of the cost of ship repair. It is one thing to tax, say, the cost of cleaning up after repairs; it is quite another to assess a duty of $50,000 on a $50,000 repair. That is not extrapolation. It is the creation of a new and substantial liability, unrelated to the 50% duty assessed by statute.

Such a radical recasting of the vessel repair statute should be a matter for Congress, not for the Customs Service or a badly divided appeals court panel. It is especially unwarranted when the Customs Service recently failed to interest Congress in an amendment to the repair statute that would have made dry-docking and other expenses "associated" with repairs dutiable. *Supra* at 9. After that proposed amendment failed, Customs undertook unilaterally to redefine the statute. The Federal Circuit should not have allowed that, and this Court should not permit the redefinition to stand.

Moreover, by imposing significant new operating costs on U.S.-flag vessel owners, Customs and the Federal Circuit not only transgress their institutional bounds, but also they directly undermine federal policy. As discussed *supra* at 5, Congress over the past few decades has responded to the flagging state of the merchant marine with legislation designed to make the industry more competitive. Against this backdrop, it is exceedingly unlikely that Congress would sanction a major expansion of the vessel repair duty when the commercial shipping industry is struggling merely to survive. In fact, the nearest analogue is exactly to the contrary: in

1943, with the maritime fleet depleted by wartime losses (and domestic shipyards operating at capacity), Congress *suspended* the repair duty until the industry was back on its feet. See Act of Dec. 17, 1943, ch. 345, 57 Stat. 601.

II. THE FEDERAL CIRCUIT'S RULING INFLICTS SUBSTANTIAL HARM ON THE U.S. MERCHANT FLEET WITH NO COUNTERVAILING BENEFIT.

If allowed to stand unreviewed, the decision below will have serious adverse effects on the U.S.-flag fleet. Dry-docking is a routine part of doing business for commercial vessel owners; indeed, as in this case, periodic dry-docking is *required* by the Coast Guard rules governing U.S.-flag vessels. And it is very expensive—shipyard dry-docking and overhaul constitute one of the biggest items in a cargo vessel's operating budget (after fuel, labor, and onboard maintenance and repairs). Since a merchant ship has repairs done virtually every time it is in dry dock, the duty assessment rule announced by the Federal Circuit in this case ensures that the previously (and historically) limited vessel repair duty will now capture a significant portion of the operating expenses of U.S.-flag vessels.[12]

Moreover, set against these substantial harms is no identifiable benefit, apart from an uptick in federal revenue (a pyrrhic victory for the public fisc if the industry continues to decline). The new rule does not further the purpose of the vessel repair statute, which is "to encourage U.S. shipowners to

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[12] Even if a ship owner, to limit its exposure to vessel repair duties, refrained from having an expensive dutiable repair performed while the ship was in dry dock in a foreign port, the owner would then have to dock the ship again in the U.S. (for any repair requiring dry-docking). That is, a vessel owner in this circumstance is given the Hobson's choice between, on the one hand, incurring substantial duties on foreign dry-docking and, on the other, paying twice for dry-docking and taking the ship out of commission for additional days or weeks—this on top of the declining capacity of domestic shipyards and the often vastly higher costs of having the work done in the United States.

employ U.S. labor whenever possible." *Mount Washington Tanker Co.* v. *United States*, 665 F.2d 340, 344 (C.C.P.A. 1981). As noted above, American shipyards are often unavailable to repair private cargo vessels (indicating that the domestic yards are hardly starving for business). In almost all cases, therefore, U.S.-flag vessel owners engaged in overseas trade will have no realistic choice but to absorb the additional duties, and thus become less competitive—or get out of the business altogether.

In sum, the decision below has no warrant in the statute or historical practice. Without any substantive change in the vessel repair statute, the Federal Circuit has approved the assessment of repair duties on dry-docking expenses that for a century had not been dutiable and would not be dutiable under the Federal Circuit's prior "but-for" construction of the statute. The test created by the Federal Circuit is arbitrary in application, creates confusion in administration, and promises further to weaken an industry with deep strategic importance to our nation. For these reasons the holding of the divided panel warrants review by this Court.

CONCLUSION

For the foregoing reasons, the petition for writ of certiorari should be granted.

Respectfully submitted,

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